

**Audit of Personnel Classification Support  
Services Contract**

**September 2003**

**Reference Number: 2003-10-194**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**

**Redaction Legend:** 3d = Identifying information - Other Identifying Information of an Individual or Individuals



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

September 5, 2003

MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Assistant Inspector General for Audit (Small Business and  
Corporate Programs)

SUBJECT: Final Audit Report - Audit of Personnel Classification Support  
Services Contract (Audit #200310021)

This report presents the results of our review of the personnel classification support services contract. The overall objective of this review was to determine if the contractor billed the Internal Revenue Service (IRS) accurately and according to the contract's terms and conditions.

Contract expenditures represent a significant outlay of IRS funds. The Treasury Inspector General for Tax Administration (TIGTA) has made a commitment to perform audits of these expenditures. As a result, the TIGTA initiated this audit to review the contractor's invoices and determine if the IRS was billed accurately and according to the contract's terms and conditions.

In summary, we determined that the contractor's documentation was not adequate to support some of the costs invoiced to the IRS. Specifically, we identified approximately \$38,000 for which the contractor was either unable to provide any supporting documentation or the documentation provided did not adequately support the cost.

We did not identify any unallowable expenses<sup>1</sup> from our judgmental sample of 22 invoices totaling approximately \$326,000. Additionally, IRS personnel advised us that all services and deliverables contracted for were received. We verified the existence of a sample of these deliverables. However, the contractor did not have standardized policies and procedures relating to time reporting and approval. As a result, we identified several control deficiencies in the contractor's timekeeping system.

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<sup>1</sup> An unallowable expense is a cost incurred by the contractor that is not chargeable to Federal Government contracts.

We recommended that the Director, Procurement, seek recovery of the approximately \$38,000 in unsupported costs unless the contractor provides acceptable support for those costs, and, as part of this process, recoup the \$162 that the contractor overbilled the IRS. Additionally, the Director, Procurement, should require the contractor to implement effective timekeeping procedures with appropriate controls to substantiate the employee labor and travel hours invoiced under the contract.

Management's Response: IRS management agreed with the recommendations presented in our report and initiated corrective actions. Specifically, the IRS reviewed all invoices and documentation that the TIGTA determined to be unsupported. Based on further discussion with the contractor and additional documentation provided, the IRS determined that it had received the services and deliverables totaling the amount in question. The IRS also decided not to proceed with any action to recoup the \$162 overbilled by the contractor, stating that the administrative cost of the effort would exceed the benefit. In addition, the contractor agreed to implement effective timekeeping procedures with the requisite controls, including maintaining timesheets for all employees. The IRS will evaluate the effectiveness of the contractor's timekeeping procedures through biannual review of a random sample of invoices and associated employee timesheets and travel documentation. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have any questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations), at (202) 622-8500.

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## Audit of Personnel Classification Support Services Contract

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### Background

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In April 2001, the Internal Revenue Service (IRS) awarded an indefinite-delivery/indefinite-quantity<sup>1</sup> task order contract to provide personnel classification support services to the IRS National Classification Center (NCC) in Atlanta, Georgia. The IRS established the contract because it expected that many employees at the NCC would retire or be transferred to new positions during the classification system redesign initiative.

The contractor is to provide day-to-day operational classification support to the IRS business units and supply staff resources qualified to perform classification activities. These activities include:

- \* Conducting desk audits, position reviews, and occupational studies.
- \* Developing position descriptions.
- \* Processing grievances.
- \* Adjudicating appeals.
- \* Serving as an expert witness.

The contract, which included a 12-month base period with 4 option years, has an estimated value of nearly \$3.9 million over this 5-year period. As of March 2003, the IRS had spent approximately \$470,000.

The contractor operates a “virtual company” in that its employees work out of their homes in approximately 20 different states. As such, much of the employees’ work and correspondence is transmitted to company officials electronically via fax and electronic mail (e-mail) messages.

We analyzed all 44 of the contractor’s invoices submitted from the contract’s inception through March 21, 2003, in order to select a judgmental sample. We selected a sample of 22 invoices to verify all charges, including labor hours, travel hours, and travel expenses (e.g., airfare, hotel, mileage), and reviewed the contractor’s supporting

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<sup>1</sup> In an indefinite-delivery/indefinite-quantity contract, the time of delivery is not specified but established during performance, and the exact quantity to be ordered is unknown but specified within minimum and maximum limits.

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documentation. Our sample covered approximately \$326,000 (almost 70 percent) of the total amount invoiced and approximately \$16,000 (nearly 80 percent) of the total travel expenses invoiced.

Contract expenditures represent a significant outlay of IRS funds. The Treasury Inspector General for Tax Administration (TIGTA) has made a commitment to perform audits of these expenditures. As a result, the TIGTA initiated this audit to review the contractor's invoices and determine if the IRS was billed accurately and according to the contract's terms and conditions.

The audit work was performed from March through July 2003 in the Strategic Human Resources directorate within the Office of the Commissioner in Arlington, Virginia, and in the Procurement directorate within the Agency-Wide Shared Services function in Oxon Hill, Maryland. In addition, we interviewed the contractor's project manager and reviewed contractor records in Atlanta, Georgia.

The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **Inadequate Documentation to Support Some Invoiced Costs**

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The contractor's documentation was not adequate to support some of the costs invoiced to the IRS. Using a judgmental sample of 22 invoices, we examined the contractor's supporting documentation to verify charges for employee labor and travel hours, as well as travel expenses. We identified approximately \$38,000 in invoiced costs for which the contractor was either unable to provide any supporting documentation or the documentation did not adequately support the cost. Nearly all of the unsupported costs related to labor hours.

We also determined that the contractor overbilled the IRS \$162 due to an incorrect calculation in travel hours and an incorrect adjustment made to travel expenses. Specifically, we identified 1 employee who incorrectly calculated travel time by 3 hours when traveling between time zones. Additionally, we identified an incorrect adjustment made by

## Audit of Personnel Classification Support Services Contract

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the contractor's project manager. In this instance, the employee had claimed a parking expense of \$30, but the project manager changed the expense to \$50 based on the receipt rather than the actual amount claimed. The employee had noted on 3d--voucher, however, that 3d-- remained 2 extra days for personal reasons, thus incurring 2 additional days of parking expense.

The following table summarizes the questioned costs identified during our review:

Questioned Activity	Questioned Cost
No documentation to support labor hours invoiced.	\$33,038
Documentation supports a lesser amount of labor hours than invoiced.	1,637
Payroll records reflect a lesser amount paid to the employee than invoiced.	3,110 <sup>2</sup>
Incorrect calculation of travel hours.	142
Incorrect adjustment to travel expenses.	20
<b>Total</b>	<b>\$37,947</b>

Source: TIGTA analysis of 22 invoices submitted to the IRS.

The Federal Acquisition Regulation<sup>3</sup> provides that a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred. Because we were unable to verify these costs, there is no assurance that the contractor billed the IRS accurately.

### Recommendation

1. The Director, Procurement, should seek recovery of the \$37,947 in unsupported costs unless the contractor provides acceptable support for those costs, and, as part of this process, recoup the \$162 that the contractor overbilled the IRS.

Management's Response: The contracting officer reviewed all invoices and documentation that the TIGTA determined

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<sup>2</sup> Because it is already reflected in "No documentation to support labor hours invoiced," \$608 is not included in this figure.

<sup>3</sup> Federal Acquisition Regulation, 48 C.F.R. pt 1-53 (2002).

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### Inadequate Controls Over the Timekeeping System

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to be unsupported. Based on further discussion with the contractor and additional documentation provided, the contracting officer determined that the IRS received the services and deliverables totaling the amount in question. The IRS will not proceed with any action to recoup the \$162, as the administrative cost of the effort would exceed any benefit.

We did not identify any unallowable expenses<sup>4</sup> from our judgmental sample of 22 invoices totaling approximately \$326,000. Additionally, IRS personnel advised us that all services and deliverables contracted for were received. We verified the existence of a sample of these deliverables. However, the contractor did not have standardized policies and procedures relating to time reporting and approval. As a result, we identified the following control deficiencies in the contractor's timekeeping system:

- \* The employees did not submit timesheets accounting for hours worked by project.
- \* The project manager changed employee hours without concurrence from the employee or approval from a higher management official.
- \* The project manager approved 3d--own time.

Because the contractor's employees work out of their homes, the employees submit their hours to the project manager by e-mail. However, the contractor did not require the employees to follow a standard format or use a standardized timesheet to account for their hours by project. By not requiring employees to document their hours by project, the potential exists for multiple contracts to be billed for the same employee hours.

We also identified two instances where the project manager increased an employee's hours, but there was no documentation to support that the change had been agreed to by the employee or authorized by a higher-level manager. Although the amount of time added in both cases was minimal – 2.5 hours in the first instance and 1 hour in the

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<sup>4</sup> An unallowable expense is a cost incurred by the contractor that is not chargeable to Federal Government contracts.



second instance – it still represents a breakdown in the contractor's timekeeping controls. To deter improper actions by any one individual, changes to an employee's time should be initialed by the employee and approved by a higher-level manager. This process should be properly documented.

In addition, we determined that the hours charged to the contract by the project manager were not reviewed and approved by a higher-level manager. Instead, the project manager forwarded 3d- time, along with the time of the other employees, directly to the individual responsible for payroll submission. While the project manager did maintain a detailed spreadsheet accounting for 3d- time, the lack of review and approval of this time by a higher management official increases the risk for error or manipulation.

The General Accounting Office's *Standards for Internal Controls in the Federal Government* explains that to reduce this risk, key duties and responsibilities need to be divided or segregated among different people. This should include separating the responsibilities for authorizing, processing, recording, and reviewing transactions. The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* report provides similar guidance for the private sector.

Internal controls serve as the first line of defense in safeguarding an organization's assets and preventing and detecting errors and fraud. Internal control activities include a wide range of activities such as approvals, authorizations, verifications, reconciliations, and the creation and maintenance of related records which provide evidence of execution as well as appropriate documentation of these activities. Control activities help to ensure that all transactions are completely and accurately recorded.

Inadequate controls increase the potential for errors and fraud to occur. Because of control deficiencies in the contractor's timekeeping system, IRS expenditures of approximately \$310,000 in labor and travel hour charges for this contract were vulnerable to an increased risk of error or manipulation.

**Recommendation**

2. The Director, Procurement, should require the contractor to implement effective timekeeping procedures with appropriate controls (e.g., standardized timesheets; employee time broken down by project; recordation, review, change, and approval procedures) to substantiate the employee labor and travel hours invoiced under the contract.

Management's Response: The contractor has agreed to implement effective timekeeping procedures with the requisite controls, including maintaining timesheets for all employees. The contracting officer will evaluate the effectiveness of the contractor's timekeeping procedures through biannual review of a random sample of invoices and associated employee timesheets and travel documentation.

**Detailed Objective, Scope, and Methodology**

The overall objective of this review was to determine if the contractor billed the Internal Revenue Service (IRS) accurately and according to the contract's terms and conditions. We accomplished this objective by ensuring that contractor billings were adequately supported and all costs were allowable through performing the following audit steps:

- I. Determined whether labor hours, labor categories and rates, and travel costs billed were allowable, accurate and supported by appropriate documentation, and consistent with contract terms and conditions.
  - A. Reviewed the IRS' contract files to identify all applicable contract terms and conditions and determined the minimum contract qualifications required for each labor category and corresponding labor rates.
  - B. Interviewed IRS personnel involved in the administration of the contract and payment of the invoices to determine if concerns existed regarding the contractor, its billing practices, or any specific invoices.
  - C. Prepared a sampling plan and judgmentally selected a sample of invoices. A judgment sample was used because we did not plan on projecting the results to the universe. We selected 22 of 44 invoices submitted from the inception of the contract through March 21, 2003. The sample covered approximately \$326,000 of nearly \$470,000 in total invoiced expenses. In addition, the sample included over \$16,000 of the approximately \$20,000 in invoiced travel expenses.
    1. Traced employee hours billed to supporting timesheets and payroll records to verify accuracy.
    2. Compared the labor rates billed to those established in the contract to verify consistency with the contract terms.
- II. Identified control deficiencies that allowed the payment of invoices containing inaccurate, unsupported, and/or unallowable labor and travel costs to occur. We did not review the contractor's entire systems of internal controls.
- III. Ensured the IRS received the deliverables as required by the contract (verification of existence of deliverables).

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- A. Prepared a sampling plan for use in judgmentally selecting a sample of completed task orders to verify existence of deliverables. We obtained two spreadsheets containing 75 closed cases from the IRS National Classification Center. We did not validate the information contained in these spreadsheets. We selected 22 closed cases that traced back to the 22 invoices selected in our prior sample and verified the IRS received the deliverables. We used a judgmental sample because we were not going to project the results to the entire population.
- B. Reviewed the contracting officer and contracting officer technical representative files and interviewed IRS personnel to determine if problems were identified with the deliverables.

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

John R. Wright, Director

Debra Gregory, Audit Manager

Thomas Dori, Senior Auditor

Gwen Bryant-Hill, Auditor

Chinita Coates, Auditor

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**Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- \* Cost Savings, Questioned Costs (Unsupported) – Potential; \$37,947<sup>1</sup> (see page 2).
- \* Protection of Resources – Potential; approximately \$310,000 (see page 4).

Methodology Used to Measure the Reported Benefits:

To determine the questioned costs, we interviewed contractor personnel and reviewed a judgmental sample of 22 invoices, including the corresponding supporting documentation. We selected our sample from a total population of 44 invoices that the contractor submitted to the Internal Revenue Service from the contract's inception through March 21, 2003. We identified \$37,947 in costs for which the contractor was either unable to provide any supporting documentation or the documentation provided was not sufficient to support the cost.

Due to weaknesses in the contractor's controls over timekeeping, we determined that approximately \$310,000 was at an increased risk for error and manipulation. The \$310,000 is the total amount of employee labor and travel hours on the 22 invoices included in our sample.

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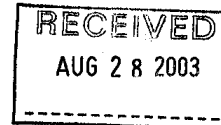
<sup>1</sup> All but an immaterial amount (\$20) of this figure is also included in the \$310,000 protection of resources.

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

August 27, 2003



MEMORANDUM FOR GORDON C. MILBOURN III  
ASSISTANT INSPECTOR GENERAL FOR AUDIT  
(SMALL BUSINESS AND CORPORATE PROGRAMS)

FROM: David A. Grant *David A. Grant*  
Director, Procurement

SUBJECT: TIGTA Draft Report – Audit of Personnel Classification Support  
Services Contract (Audit No. 200310021)

We have reviewed the subject audit report and agree with your recommendations. We share your commitment to ensure the IRS pays contractors only for supplies and services provided in accordance with contract terms and conditions. The attachment provides corrective actions taken in response to your recommendations.

The report cites two areas of measurable benefits resulting from your audit. In the first case, we have reviewed additional support provided by the contractor for \$38,000 in invoiced costs and found the costs allowable. In the second, we believe the \$310,000 you determined at risk due to weaknesses in the contractor's timekeeping practices is overstated; however, we understand your methodology for assessing the risk so broadly.

If you have any questions, please call me at (202) 622-8480 or J.T. Smith, Director, Office of Contract Administration, at (202) 283-1710.

Attachment



## Audit of Personnel Classification Support Services Contract

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### ATTACHMENT

#### **TIGTA Draft Report – Audit of Personnel Classification Support Services Contract (Audit No. 200310021)**

##### **RECOMMENDATION 1:**

The Director, Office of Procurement, should seek recovery of the \$37,947 in unsupported costs unless the contractor provides acceptable support for those costs, and, as part of this process, recoup the \$162 that the contractor overbilled the IRS.

##### **CORRECTIVE ACTION:**

The Contracting Officer has reviewed all invoices and documentation determined to be unsupported by the TIGTA audit team. Based on further discussion with the contractor and additional documentation provided, as well as additional information on deliverables from the Contracting Officer's Technical Representative (COTR), the Contracting Officer determined the IRS has received the services and deliverables totaling the amount in question.

The administrative cost of the effort to recover the \$162 overbilled by the contractor would far exceed any benefit; therefore, we will not proceed with any action to recoup this amount.

**COMPLETED:** August 20, 2003

##### **RESPONSIBLE OFFICIAL:**

Director, Procurement A:P

##### **CORRECTIVE ACTION MONITORING PLAN:**

The Contracting Officer and the COTR will monitor contractor invoices in accordance with the Federal Acquisition Regulation (FAR).

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### **RECOMMENDATION 2:**

The Director, Office of Procurement, should require the contractor to implement effective timekeeping procedures with appropriate controls (e.g., standardized timesheets; employee time broken down by project; recordation, review, change, and approval procedures) to substantiate the employee labor and travel hours invoiced under the contract.

### **CORRECTIVE ACTION:**

The contractor has agreed to implement effective timekeeping procedures with the requisite controls. In addition, the contractor will maintain timesheets for all employees and make them available to the COTR and Contracting Officer for review.

**COMPLETED:** August 20, 2003

### **RESPONSIBLE OFFICIAL:**

Director, Procurement A:P

### **CORRECTIVE ACTION MONITORING PLAN:**

The Contracting Officer will evaluate the effectiveness of the contractor's timekeeping procedures through biannual review of a random sample of invoices and associated employee timesheets and travel documentation.